BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

Noranda Aluminum, et al., Complainants	)	
	)	
v.	)	Case No. EC-2014-0223
	)	
Union Electric Company d/b/a Ameren Missouri, Respondent.	)	

INITIAL POST-HEARING BRIEF OF COMPLAINANTS

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ATTORNEYS FOR COMPLAINANTS

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I. INTRODUCTION

The undisputed facts show that Union Electric Company, d/b/a Ameren Missouri ("Ameren") has been earning above its authorized return on equity ("ROE"), or "overearning," at least since the twelve months ended June 2012 and continuing through the twelve months ended March 2014. Indeed, it overearned by almost $140 million in one twelve month period. Complainants believe that the reason Ameren has been consistently overearning is because its rates are too high. Accordingly, Complainants brought this complaint against Ameren and request that the Commission lower Ameren's rates to just and reasonable levels.

Complainants understand that overearning by itself does not prove that rates are too high. Thus, Complainants presented the expert testimony of Greg Meyer. He normalized and annualized all relevant factors,[1] twelve specific adjustments, to determine whether the overearning was due to rates that were too high, or rather due to other factors (such as abnormal weather). He concluded that, on a normalized and annualized basis, rates were too high by $49.442 million a year based upon the financial information prepared by Ameren and included in the December 2013 surveillance monitoring report.[2] That figure includes a $23.1 million adjustment for the fact that the current ROE, at 9.8 percent, is .4 percent too high. It also

[1] Tr. p. 174, ll. 16–25.

[2] Meyer Surrebuttal, Ex. 2, as corrected at trial, Tr. p. 160, l. 10 - p. 161, l. 16.

represents a $10 million adjustment lowering overearnings for solar rebate costs that have been deferred. Without the solar rebate adjustment,[3] and including the ROE adjustment, Ameren's rates are $59.442 million per year too high.

All consumer parties, including Public Counsel, support the reduction in Ameren's rates or, in the case of one consumer party, take no position.

The Staff, while recognizing that Ameren has been earning above its authorized ROE, nevertheless argues that no rate reduction is in order because of: (1) Ameren's deferred solar rebate expenditures; (2) Ameren's planned capital expenditures; and (3) the fact that Complainants did not perform a detailed audit of Ameren's books and records.

Predictably, Ameren opposes a rate reduction. It argues that the Commission should consider its deferred solar rebate expenditures as a basis for denying relief. It also argues that the Commission should consider future expenditures that it plans to make, many of which may be made after a likely decision in this case. Further, it argues that its authorized ROE should not be reduced, and in fact should be increased. Last, it argues that Complainants' evidence did not present "all relevant factors" because that evidence did not include a detailed audit of Ameren's books and records as Staff would perform when it investigates a rate case filing.

Notwithstanding Ameren's and Staff's position to the contrary, this Commission should order a rate reduction of $49.442 million per year because: (1) Ameren's claim that its capital spending should defeat the rate decrease is belied by the fact that its rate base as of March 31, 2014, was $180 million lower than the rate base to set its current rates;[4] (2) Ameren's planned future expenditures should not be a basis to defeat a rate decrease since they are not known and

[3] As explained below, it is unfair to consumers to use deferred solar rebate costs as a basis for determining whether Ameren's current rates are excessive given that Ameren is seeking the full recovery of these expenses in rates to be set in its pending rate case.

[4] Tr. p. 178, l. 17 – p. 179, l. 8.

measurable as many of those investments will not be in service prior to the Commission order in this case; (3) a just and reasonable ROE is 9.4 percent; and (4) Complainants performed an analysis of all relevant factors sufficient to meet any reasonable interpretation of Missouri law and not render that law an absurdity.

II. POSTURE OF THE CASE

In its June 6, 2014 Order Denying Reconsideration and Offering Clarification, the Commission accurately and succinctly summarized the nature of this proceeding. The Commission stated, on page 2:

> The action brought by the Complainants is a rate complaint….Staff and Ameren Missouri have time to do only a limited investigation of the allegations made by the Complainants. If either party's investigation indicates the Complainants have not met their burden of establishing all relevant factors necessary to set a just and reasonable prospective rate, Staff or Ameren Missouri may take that position at the hearing. But whether the Complainants have met their burden is an issue the Commission will decide after considering all competent evidence on the record. The Complainant may not be able to meet that very heavy burden, but if they are able to do so, the commission can establish new rates in response to the complaint.

A. Burden of Proof

The "burden of proof" can be analyzed by breaking it into its component parts, the burden of persuasion and the burden of going forward with the evidence. The burden of persuasion, as distinct from the burden of producing evidence, at all times is on the Complainants and never shifts.[5]

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5 *Kinzenbaw v. Director of Revenue*, 62 S.W.3d 49, 50, 53 (Mo. banc 2001).

In this case, the burden of persuasion is the obligation to establish, by a preponderance of the evidence and considering "all relevant factors," that Ameren's rates are too high and should be lowered. That burden rests on the Complainants, and the Complainants only, and does not shift during the course of the proceeding. On the other hand, while the burden of producing evidence rests with the Complainants, once the Complainants have offered sufficient evidence to prove that Ameren's rates are too high, if Ameren fails to produce sufficient evidence to rebut Complainants' evidence, then Complainants will have met their burden of proof.[6]

Accordingly, Ameren, as Respondent, is compelled to controvert the evidence in Complainants' case in chief. In this case, Ameren proposed no adjustments to Complainants' *prima facie* case other than to introduce the testimony of Robert Hevert on the Return on Equity issue. Complainants respond below to Hevert's testimony.

The Staff also introduced evidence attempting to controvert a number of elements in Complainants' *prima facie* case. Staff advised the Commission and the other parties early in this case that it did not have the opportunity to address every element of Complainants' *prima facie* case due to resource and time limitations.

In response to the contravening evidence of Ameren and Staff, Complainants introduced additional evidence in their surrebuttal testimony. Staff also filed surrebuttal testimony to address clarifications in light of the rebuttal testimony and to restate its overall position in light thereof. No other party to the case introduced evidence for the Commission's consideration. The evidence is described in more detail below.

[6] *Johnson v. Missouri Gas Energy*, 2008 WL 4922366, *13 (Mo. P.S.C. Nov. 6, 2008); *Howard v. Union Electric Company*, 2008 WL 5274284 (Mo. P.S.C. Dec. 11, 2008).

B. The Parties

The Complainants in this case are Noranda Aluminum, Inc. and thirty-seven (37) individual Ameren customers who filed their Complaint against Ameren on February 12, 2014. The Complainants are authorized to maintain a rate complaint by Sections 393.130.1, 386.390, and 393.260 RSMo., and 4 CSR 240-2.070(4) and (5). Complainants allege that Ameren's current rates are too high, permitting Ameren to earn a return on its equity in excess of that authorized by the Missouri Public Service Commission (Commission) in Ameren's last rate case, ER-2012-0166, and greater than what is now a reasonable return.

Respondent is Ameren, which is a Commission-regulated electric public utility. Ameren has the burden of going forward with the evidence after Complainants establish their *prima facie* case.

Both the Staff of the Commission and the Office of the Public Counsel are parties to rate proceedings without the necessity of intervention. Other intervenors in the case include Missouri Industrial Energy Consumers, Missouri Consumers Council, AARP, River Cement, Continental Cement, Missouri Retailers Association, Sam's Club East and Wal-Mart East, and the Cities of O'Fallon and Ballwin. United for Missouri has been granted leave to file a brief *amicus curiae*.

C. Regulatory Principles

1. All Relevant Factors

Statutory and case law require the Commission to consider "all relevant factors" in setting rates for regulated utilities.[7] All cost and revenue factors affecting Ameren's cost of service are reflected in its financial books kept pursuant to the Uniform System of Accounts

[7] *State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission*, 585 S.W.2d 41, 56 (Mo. banc 1979); section 393.270.4.

(USOA),[8] plus its cost of equity. Adjustments to amounts recorded in the USOA accounts by Complainants and Staff refined the value of the relevant factors, but did not subtract or add additional relevant factors.[9]

2. Matching Principle

The matching principle is designed to keep revenues, expenses and rate base in a proper relationship for a set period of time.[10] Employing a test period helps implement the matching principle by providing the Commission a common basis for considering utility revenues and expenses over an annual period, so that rates going forward will maintain the same, balanced relationship. The matching principle is a cornerstone in the use of historical data to establish rates. In this case, both Complainants and Staff used the twelve months ending December 31, 2013, as a test period.

3. Regulatory Lag

Regulatory lag results from the changes in the utility's revenues and expenses between the time that rates are set and the current period. Those changes can cause the utility to either overearn or underearn relative to its authorized ROE until the time when rates are changed to bring revenues and expenses back into balance.[11]

The evidence in this case shows that Ameren has benefited from regulatory lag and overearned since June 2012 (i.e., revenues exceeded costs plus its authorized ROE).[12] The evidence presented by Ameren also shows that overearnings resulting from regulatory lag will reverse <u>at some point in the future</u>, but after this case is scheduled to be decided, to benefit

[8] Tr. p. 173, ll. 7-17; p. 343, l. 11 - p. 346, l. 6.

[9] Tr. p. 164, l. 8 – p. 166, l. 22.

[10] Tr. p. 339, ll. 9-13.

[11] See, *State ex rel. Laclede Gas Company v. Public Service Comm'n*, 535 S.W.2d 561, 570 (Mo. App. K.C.D. 1976).

[12] Exs. 17-22.

customers if Ameren's plant construction projects are placed in service and its fuel and payroll costs increase as anticipated.[13] The evidence also shows that Ameren's general rate case filing in July 2014 was the earliest that Ameren could seek relief to address plant investment placed in service at the end of 2014.[14] In other words, the fact that at some point in the future Ameren will no longer be overearning on a normalized and annualized basis does not change the fact that its rates are now too high, and do not justify Ameren's continued overearnings at this time.

III. THE PRE-FILED EVIDENCE

A. Complainants' *Prima Facie* Case

Complainants' *prima facie* case is based on the direct testimony of Greg Meyer and Michael Gorman. Meyer's direct testimony analysis relied on Ameren's surveillance report for the twelve months ending September 30, 2013.[15] That report conclusively establishes that for that period Ameren overearned on an unadjusted basis, that is, exceeded its Commission-authorized return on equity, by more than $29 million. The undisputed evidence shows that Ameren overearned in each of its eight surveillance reports from June 2012 through March 2014.[16] Although not part of Complainants' prefiled evidence, Exhibit 21, produced below, shows Ameren's overearnings, as high as $140 million per year, on those eight reports:

[13] Weiss Rebuttal, Ex. 5, p. 26, l. 5 – p. 27, l. 4.

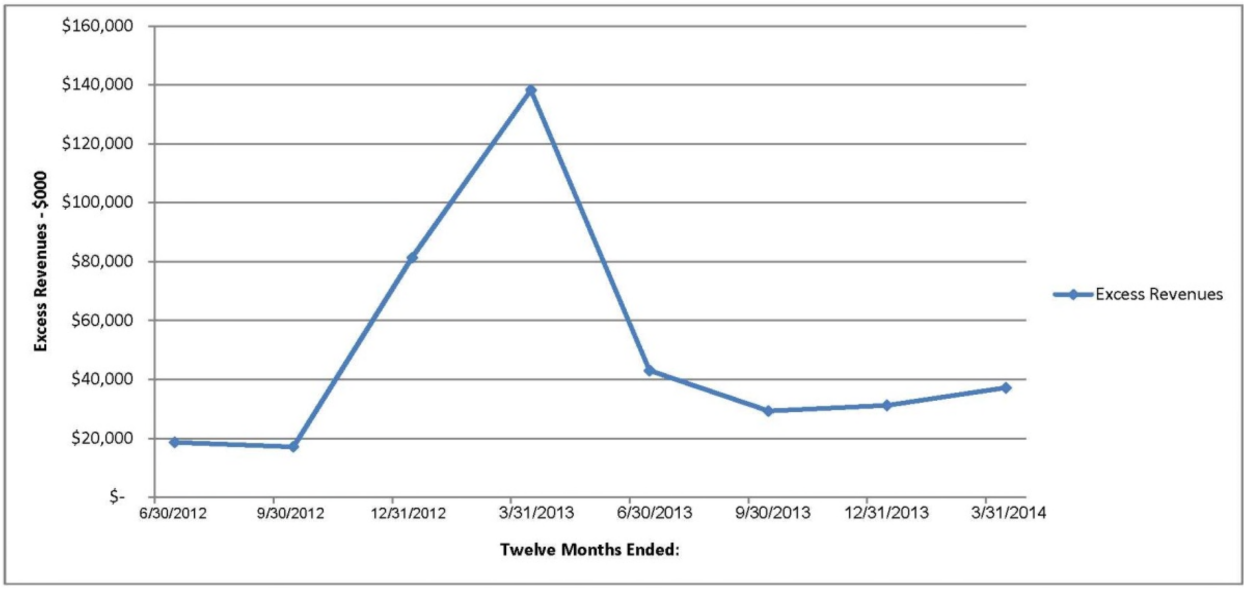
[14] Tr. p. 342, l. 17 – p. 343, l. 3.

[15] Ex. 1, p. 5, Table 1.

[16] Exs. 17-22.

Ameren Missouri

Excess Revenues



Complainants and Meyer recognize that Ameren's actual overearnings do not automatically mean that its rates are too high. In order to determine if its rates are too high, Meyer annualized and normalized Ameren's expenses and revenues. In doing so, Meyer included all factors relevant to Ameren's revenue requirement. No financial item from Ameren's comprehensive USOA accounting records forming the basis of the surveillance reports was excluded.[17] In his direct testimony, Meyer proposed the following adjustments to annualize and normalize Ameren's financial information kept according to the USOA as reported in Ameren's September 2013 surveillance report:[18]

[17] Tr. p. 164, l. 8 – p. 166, l. 22.

[18] Ex. 1, p. 5, Table 1.

Ameren Missouri's Overearnings and Justified Rate Increase or Decrease	
Description	**Amount of Rate Increase Or Decrease ($000)**
Ameren Missouri's Earnings in Excess of 9.8% ROE As Reported in the September 30, 2013 Surveillance Report	($29,191)
Adjustment to Reported Results	
1. Rate of Return at 9.40%	($22,491)
2. Rate Case Revenue Annualization	($28,208)
3. Elimination of Rate Refunds	($25,548)
4. Callaway Refueling Normalization	($12,700)
5. Long-Term Incentive and Stock Compensation Disallowance	($13,927)
6. Disallowance of Certain Miscellaneous & Advertising Expenses	($ 2,009)
7. Steam Production Maintenance Expenses Normalization	$ 28,161
8. Distribution Maintenance Expenses Normalization	$ 18,189
9. Pensions and OPEB Expense	$ 5,722
10. Annualization of Depreciation Expense	$ 5,353
11. Annualization of Labor Expense	$ 7,010
12. Healthcare Expense Annualization	$ 656
13. Annualization of Amortization Expense	$ 1,126
14. Interest on Customer Deposits Annualization	$ 727
Adjusted September 30, 2013 Surveillance Earnings	($67,130)

As noted in that testimony and above, $22.49 million of the normalized and annualized overearnings are attributable to Ameren having an authorized ROE that is .4 percent too high (9.8 percent - 9.4 percent). In support of a just and reasonable ROE of 9.4 percent, Complainants offered the testimonies of Michael Gorman.[19] Also, as explained in Meyer's surrebuttal

[19] Gorman Direct, Ex. 3 and Gorman Surrebuttal, Ex. 4.

testimony,[20] his direct testimony did not provide a weather normalization because Ameren's September 2013 surveillance report incorrectly indicated milder than normal weather and Meyer at that time biased his analysis in favor of Ameren in that one respect.

B. Ameren's Rebuttal Evidence

Although Ameren filed more than a half dozen procedural motions and responses, it offered only two substantive witnesses in opposition to Complainant's direct *prima facie* case and neither proposed an adjustment. Robert Hevert analyzed fourteen of the twenty-three utilities analyzed by Gorman, added a new company to the proxy group, and recommended a 10.4 percent return on equity, the mid-point of his range of 10.2 percent to 10.6 percent.[21] Lynn Barnes noted plant placed in service by Ameren since its last rate case, or will place in service by the end of 2014,[22] but she did not propose an adjustment. Ameren also presented testimony from John Reed on regulatory policy and Gary Weiss, who criticizes the adjustments proposed by Meyer, but offers no adjustments himself.[23]

C. Staff's Rebuttal Evidence

Staff proposed a number of adjustments to Complainant's *prima facie* case. First, Staff based its analysis on Ameren's surveillance report for the twelve months ending December 31, 2013, a report not available to Complainants when they prepared their direct case. Staff proposed adjustments for weather normalization through the testimony of Seoung Joun Won, and Staff witness, Shawn Lange[24] for normalized revenues. Staff also provided the testimony of Mark Oligschlaeger, who explained Staff's approach to analyzing overearnings at regulated utilities. Oligschlaeger noted that Staff expected the rate impact of Ameren's solar rebate

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[20] Ex. 2, p. 6, l. 18 – p. 9, l. 32.

[21] Hevert Rebuttal, Ex. 7, p. 61, ll. 10-13.

[22] Barnes Rebuttal, Ex. 6, p. 4, l. 9 – p. 5, l. 11.

[23] Weiss Rebuttal, Ex. 5; Reed Rebuttal, Ex. 8.

[24] Won Rebuttal, Ex. 9; Lange Rebuttal, Ex. 10.

program to be recognized in its now pending rate case, ER-2014-0258.[25] Using Ameren's currently authorized 9.8 percent return on equity, and the Staff's own weather normalization calculations, John Cassidy presented the adjustments shown below, opining that Ameren was annually earning $27.6 million in excess of its authorized return.[26]

Description	**$ in thousands**
Ameren Missouri 12/31/13 earnings in excess of 9.8% ROE	$(31,186)
Elimination of rate refunds	$(25,548)
Callaway refueling normalization	$(12,800)
Non-Labor Steam Production Maintenance Expense	$ 0
Non-Labor Distribution Maintenance Expense	$ 0
Long & Short-Term Incentive Compensation Disallowance	$(13,388)
Labor	$ 4,325
Weather Normalization	$17,380
365-Days Adjustment	$ 7,477
Fuel Offset	$(11,095)
Depreciation Expense Annualization	$ 11,521
MEEIA	$ 25,700
Staff Adjusted December 31, 2013 Surveillance Earnings	$(27,614)

[25] Oligschlaeger Rebuttal, Ex. 11, p. 15, ll. 12-14.

[26] Cassidy Rebuttal, Ex. 12, p. 28, ll. 1-14.

D. Complainants' Surrebuttal Evidence

In his surrebuttal testimony, Meyer also moved his analysis to the more recent surveillance report for the twelve months ending December 31, 2013.[27] Accordingly, he modified his adjustments as shown below:[28]

Ameren Missouri's Overearnings	
Description	**Amount ($000)**
1. Ameren Missouri's December 31, 2013 Surveillance Report	($31,007)
2. Weather Normalization – Revenues	$17,380
3. Test Year Days Normalization - Revenues	$ 7,477
4. Weather and Test Year Days Normalization – Fuel	($11,095)
5. Elimination of Rate Refunds	(25,548)
6. Callaway Refueling Normalization	($12,800)
7. Long-Term Incentive and Stock Compensation Disallowance	($13,332)
8. Annualization of Depreciation Expense	$ 2,873
9. Annualization of labor Expense	$ 3,289
10. Interest on Customer Deposits Annualization	$ 723
11. Missouri Energy Efficiency Investment Act ("MEEIA")	$25,700
12. Solar Rebates	$10,000
Subtotal	($26,341)
13. Rate of Return	($23,101)
Adjusted December 31, 2013 Surveillance Earnings	($49,442)

27 Meyer Surrebuttal, Ex. 2.

28 Meyer Surrebuttal, Ex. 2, p. 4, Table 1, as corrected.

E. Staff's Surrebuttal Evidence

Staff witness Cassidy, in his surrebuttal testimony, corrected the calculation of the depreciation expense annualization, and submitted the adjustments set forth below:[29]

Description	$ in thousands
Ameren Missouri 12/31/13 earnings in excess of 9.8% ROE	$ (31,186)
Elimination of rate refunds	$ (25,548)
Callaway refueling normalization	$ (12,800)
Non-Labor Steam Production Maintenance Expense	$ 0
Non-Labor Distribution Maintenance Expense	$ 0
Long & Short-Term Incentive Compensation Disallowance	$ (13,388)
Labor	$ 4,325
Weather Normalization	$ 17,380
365-Days Adjustment	$ 7,477
Fuel Offset	$ (11,095)
Depreciation Expense Annualization	$ 0
MEEIA	$ 25,700
Staff Adjusted December 31, 2013, Surveillance Earnings	$ (39,135)

At the conclusion of surrebuttal testimony, Complainants suggest Ameren is overearning on an annualized and normalized basis by $49.464 million, including a $23.11 million adjustment for rate-of-return, while Staff opines that Ameren is overearning by $39.135 million exclusive of any adjustment to rate-of-return. Although Ameren provided an alternative rate-of-return, it did not propose an adjustment based on that evidence.

Reference to the additional evidence adduced at trial will be made in the argument, as needed.

[29] Cassidy Surrebuttal, Ex. 13, pp. 6-7.

IV. ARGUMENT

A. All Relevant Factors

All parties concede that Complainants' case includes consideration of every account balance in Ameren's Uniform System of Accounts (USOA).[30] The Staff concedes that an adjustment to every USOA account is not required in setting rates.[31] Thus, the Commission has before it all factors, with the additional testimony and evidence on Return on Equity, that are relevant in determining Ameren's revenue requirement.

In the pre-filed testimony and the testimony at hearing, there appeared some confusion over the terms "all relevant factors," "adjustments," "materiality," and "sustainability." Review of the testimony in context should dispel any confusion.

Adjustments to annualize and normalize the amounts recorded in Ameren's USOA accounts improve the usefulness of the records in determining revenue requirement. Both Complainants and Staff, for instance, agree that Ameren's sales and revenues need to be adjusted to reflect normalized weather. Both Staff and Complainants acknowledge that adjustments for the number of days in the test year, the elimination of rate refunds, Callaway refueling expense, long-term incentive and stock compensation, fuel costs to reflect normalized revenues, and Missouri Energy Efficiency Investment Act expenses should be adjusted to better reflect an appropriate relationship among Ameren's revenues, expenses, and rate base in setting rates. Ameren proposed not a single adjustment to its booked accounts. Both Complainants and Staff agree that no regulatory or accounting principle requires an adjustment be made to every account in a rate case proceeding.[32]

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[30] Tr. p. 345, l. 23 – p. 346, l. 4.

[31] Tr. p. 344, ll. 18-21.

[32] Tr. p. 344, ll. 18-21.

Both Staff and Ameren argue that because Complainants did not perform a time-consuming, comprehensive and complete audit of Ameren's books and records similar to what the Staff would perform before bringing an overearnings complaint or in a rate case, that Complainants have not presented "all relevant factors."[33] Meyer noted however that no party other than Staff (not even OPC) could ever bring an overearnings rate complaint if the "all relevant factors" requirement can only be met by conducting a time-consuming, comprehensive, and complete audit of Ameren's books and records.[34] First, Meyer noted that most consumers have no or limited access to the utility's key financial information.[35] Second, Staff's and Ameren's construction of "all relevant factors" renders the right of customers to bring rate complaints an illusory right. Section 386.390.1 expressly allows customers to file complaint cases "as to the reasonableness of any rates or charges[.]" Similarly, section 393.260.1 allows customers to file a complaint "as to the price of electricity[.]" Likewise, this Commission's regulation 4 CSR 240-2.070(4) and (5) also allows for complaints "as to the reasonableness of any rates[.]" So while the law expressly allows these rate complaints, Staff's and Ameren's interpretation of the "all relevant factors" requirement effectively precludes any consumers from ever successfully prosecuting such a complaint. As the Chairman correctly observed, "[t]hat would be an absurd result."[36] Recognizing the absurdity of the position of Staff and Ameren in this regard, Meyer noted that it was for the Commission, not the Staff or Ameren, to determine which factors are relevant in this case and, in Meyer's opinion, he presented all of the relevant factors.[37]

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[33] Cassidy Rebuttal, Ex. 12, p. 10, ll. 9-16; Reed Rebuttal, Ex. 8, p. 5, l. 19 – p. 6, l. 5.
[34] Tr. p. 219, l. 16 – p. 220, l. 15, p. 244, ll. 20-25.
[35] Tr. p. 172, ll. 5-8.
[36] Tr. p. 220, l. 15.
[37] Tr. p. 219, ll. 20-24.

Much of Staff's testimony[38] is devoted to the process Staff uses prior to filing an overearnings rate complaint against a public utility. In its preliminary steps (phases 1 and 2), Staff considers sustainability and materiality of the utility's earnings. That is, Staff expects an overearnings complaint case to take at least two years, so if the overearnings condition is not expected to last for at least two years, there is no point to bringing a formal complaint. Further, in analyzing its likely success, Staff ignores adjustments to accounts if the adjustment would be less than $4 million, again because of the uncertainty involved with a process that may take two years. It is just as clear, however, that Staff does not employ the $4 million materiality standard when actually engaged in a rate-setting proceeding, such as the present proceeding.[39] Thus for Staff's purposes neither materiality nor sustainability are cause for concern in this case.

Ameren appears to suggest, under the guise of sustainability, that granting rate relief to consumers now would somehow be unfair because the overearnings caused by regulatory lag will likely reverse late in the fourth quarter of 2014. This argument should not persuade the Commission. Ameren has taken advantage of regulatory lag in its favor continuously since the twelve months ending June 2012. In fact, at the starting point for its presently-pending rate case, ER-2014-0258, its rate base was less than the rate base used to establish current rates.

B. Return on Equity

In Ameren's last rate case, this Commission found "that 9.8 percent is a fair and reasonable return on equity for Ameren Missouri."[40] That decision was issued on December 12, 2012. The record in this case is clear that the cost of equity has declined since then, and

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[38] Oligschlaeger Rebuttal, Ex. 11, pp. 3-19.

[39] Tr. p. 396, l. 18 – p. 397, l. 11.

[40] *In the Matter of Union Electric Company, d/b/a Ameren Missouri's Tariff to Increase Its Annual Revenues for Electric Service,* File No. ER-2012-0166, Report and Order, p. 73.

therefore in setting Ameren's rate in this case, the authorized ROE should be reduced. The Commission should find that 9.4 percent is the appropriate ROE for Ameren.

In Ameren's last rate case, this Commission considered the expert testimony of Michael Gorman (whose testimony was offered by the MIEC), Ameren witness Robert Hevert and Staff witness David Murray. This Commission expressly found that "Hevert's estimation of an appropriate ROE is too high."[41] Hevert's recommended ROE in that case was 10.5 percent. This Commission recognized that a return "somewhere below 10 percent is appropriate."[42] It reached this conclusion based in part on Gorman's testimony, which it found to be "reliable and persuasive" despite its view that some adjustments to Gorman's estimates were in order.[43] Similarly in this case, the Commission should reject Hevert's recommended ROE of 10.4 percent, because it is too high, and accept the recommendation of 9.4 percent set out in the testimony of Complainants' witness Gorman.

A reduction in Ameren's authorized ROE in this case would be consistent with decisions in other electric utility rate cases. During 2012, the average authorized ROE for electric utilities (excluding the decisions from Virginia that included premiums of up to 200 basis points for generation assets) was 10.01 percent. Since 2012, there has been a downward trend in authorized returns on equity for electric utilities. As Complainants' witness Gorman points out, the average authorized ROE for electric utilities during 2013, and the first three months of 2014 declined to 9.8 percent and 9.57 percent respectively.[44] At the hearing, Gorman observed that

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41 *Id.*, p. 69.

42 *Id.*, p. 71.

43 *Id.* p. 71.

44 Gorman Surrebuttal, Ex. 4, p. 2, l. 29 – p. 3, l. 2.

the second quarter of 2014 did include a slight uptick in authorized returns on equity, but that was due to anomalous results that do not reflect the current market cost of equity.[45]

Although there has been a decline in authorized returns on equity for electric utilities, credit analysts and capital market participants have embraced electric utilities' investment outlooks by providing ample access to capital on reasonable terms and low prices. The electric utility industry credit rating has improved since 2012, at the same time authorized returns on equity have trended down.[46] This is clear evidence that the market is accepting the low capital market cost that exists currently, and that investors view utility investments as stable investments even at lower authorized returns on equity. Thus even with this recommended reduction in Ameren's ROE, Ameren will remain competitive in the capital markets and maintain its financial stability.

Although Ameren witness Hevert has recommended an ROE of 10.4 percent, even his testimony recognizes a decline in the cost of equity since Ameren's last rate case. During the pendency of the 2012 Ameren rate case, Hevert's recommended ROE range declined from a range of 10.5 percent - 11.0 percent in his direct testimony to a range of 10.25 percent - 11 percent in surrebuttal.[47] His recommended range in this case again declined to 10.2 percent - 10.6 percent with a recommended ROE of 10.4 percent in this proceeding—compared to his recommendation of 10.5 percent in the 2012 rate case. Like industry authorized returns, Hevert's recommended range of return on equity for Ameren has dropped by up to 35 basis points since he prepared his direct testimony in Ameren's last rate case. This is generally consistent with the 20 to 30 basis point decline in the industry authorized returns.

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[45] Tr. p. 292, l. 14 – p. 293, l. 7.

[46] Gorman Surrebuttal, Ex. 4, p. 3, l. 9 – p. 5, l. 8.

[47] *In the Matter of Union Electric Company, d/b/a Ameren Missouri's Tariff to Increase Its Annual Revenues for Electric Service,* File No. ER-2012-0166, Report and Order, p. 67 and Hevert Rebuttal, Ex. 21, p. 2, ll. 6 – 9.

Based on simple observation of authorized returns on equity trends, and current market cost of equity, Ameren's return on equity in this case should be *at least* 20 to 30 basis points lower than the 9.8 percent return on equity authorized in the 2012 rate case. And, for the reasons explained in Gorman's testimony, 9.4 percent is a fair and reasonable ROE for Ameren at this time.

1. Authorized Return on Equity Standards

As this Commission has consistently recognized, the approach to determining a fair cost of common equity for a regulated utility has been framed by two hallmark decisions of the U.S. Supreme Court: *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679 (1923) and *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).[48] These decisions indicate that an authorized return should: (1) be sufficient to maintain financial integrity; (2) attract capital under reasonable terms; and (3) be commensurate with returns investors could earn by investing in other enterprises of comparable risk.[49] Gorman's recommended 9.4 percent return on equity is consistent with the general standards set by these cases in that it represents fair compensation given the Company's investment risk, and will preserve the Company's financial integrity and credit standing.

2. Overview of ROE Testimony

Gorman's recommended ROE of 9.4 percent is based on the results of a constant growth DCF model using consensus analysts' growth rate projections, a sustainable rate growth DCF model, a multi-stage growth discounted cash flow ("DCF") model, a risk premium model, and a CAPM analysis.[50] These analyses used observable market information for a proxy group of

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[48] Gorman Direct, Ex. 3, p. 4, ll. 7-17.

[49] *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679 (1923) and *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

[50] Gorman Direct, Ex. 3, p. 4, l. 18 – p. 5, l. 3.

publicly traded electric utility companies. The sample companies approximate the investment risk of Ameren Missouri.[51]

The analyses and final recommendations submitted by Gorman and Ameren witness Hevert are summarized below:

Witness (Party)	**Model Analysis**	**Cost of Equity Estimates**	**Final Recommendation**
Hevert (Ameren)	DCF (2 versions) CAPM Risk Premium	8.17% -10.98% 10.27% - 12.08% 10.20% - 10.77%	10.40%
Gorman (Complainants)	DCF (3 versions) Risk Premium CAPM	8.90% 9.85% 9.18%	9.40%

The ratings agencies currently hold a favorable view of Ameren. The company's corporate credit ratings from S&P and Moody's are "BBB+" and "Baa2," respectively.[52] S&P has also assessed Ameren Missouri's business risk at "Excellent" and noted "Ameren's ratings are on CreditWatch with positive implications, reflecting the high probability of an additional upgrade once it has completed the merchant sale to Dynegy Inc."[53]

3. Discounted Cash Flow ("DCF") Model Estimates

Gorman performed three DCF analyses, while Hevert based his recommendation on only two DCF analyses. Gorman's DCF approach is distinguished from Hevert's primarily by the growth rate inputs. Gorman's analyses included a constant growth DCF model using analysts' forecasts, a constant growth DCF model using a sustainable growth rate, and a multi-stage

[51] Gorman Direct, Ex. 3, p. 5, l. 5 – p. 6, l. 15.

[52] Gorman Direct, Ex. 3, p. 5, ll. 19–24.

[53] Gorman Direct, Ex. 3, p. 3, ll. 3–17.

growth DCF model. Gorman concluded that a reasonable DCF return is 8.90 percent largely relying on his constant growth and multi-stage growth DCF models.[54]

Hevert's DCF analyses resulted in a range of 8.17 percent - 10.98 percent. Although the results of Hevert's DCF estimates are reasonably comparable to Gorman's, the underlying flaw that discredits Hevert's analysis is his interpretation of the cost of equity estimates produced by his own model. Specifically, Hevert fails to measure the true central tendencies of his DCF results by applying significantly more weight to his high-end estimates while disregarding his low-end estimates. As shown on Gorman's Schedule MPG-SR-1, the overwhelming majority of Hevert's DCF results fall below 9.5 percent. Because of the existence of both low- and high-end outliers, the best measure of Hevert's DCF analysis is by using the median results.[55]

Hevert also performed a multi-stage DCF analyses. His multi-stage DCF model produced a range of 9.55 percent - 10.59 percent. The major flaws inherent in Hevert's multi-stage DCF analysis are two-fold: 1) Hevert artificially inflates the estimates by 18-19 basis points by utilizing a quarterly compounding growth methodology, an approach this Commission has previously rejected; and 2) he relies on a GDP growth outlook that is far higher than the current consensus economists are projecting. Correcting these errors in his analysis produces mean results in the range of 8.94 percent - 9.35 percent.[56]

[54] Gorman Direct, Ex. 3, p. 18, ll. 9-14 and Table 1.

[55] Gorman Surrebuttal, Ex. 4, p. 29, l. 22 – p. 30, l. 2.

[56] Gorman Surrebuttal, Ex. 4, p. 30, ll. 13–18.

4. Risk Premium

Gorman's risk premium study is based on observable utility bond yields, and an assessment of historical ranges of equity risk premiums, reflecting the difference between the investment risk of utility stocks versus bonds. Equity risk premiums were based on estimates of the required return on common equity relative to contemporary utility bond yields. Gorman performed two risk premium studies: one based on Treasury bonds, and the other based on utility bond yields. The authorized return on equity was based on Commission approved returns on equity for utility companies over the period 1986 through the most recent data. Gorman relied on Commission-authorized returns on equity as a proxy for investor-required returns. He noted that estimating utilities' fair return on equity is a very controversial issue in rate proceedings, and commissions' findings on a fair return on equity is the best estimate of a contemporary utility bond market-required return on equity.

Gorman estimated equity risk premiums over Treasury bonds in the range of 4.41 percent to 6.31 percent, and equity risk premiums relative to utility bond investments of 3.03 percent to 4.89 percent.[57] To gauge the current outlook for utility investment risk, Gorman reviewed the spread between utility bond yields to Treasury bond yields and "Baa" utility bond yields relative to general corporate "Baa" utility bond yields. These spreads support Gorman's conclusion that the market perceives utility investment risk as low-risk stable investments in today's very turbulent marketplace. However, Gorman did express concern with the Federal Reserve's economic stimulus efforts that have impacted the long-term interest rate markets. The expectation of the discontinuation of this economic stimulus effort could create greater risk in long-term interest rates and utility cost of capital. For this reason, although the market is generally perceiving utility investments as low-risk stable investments, he proposed the equity

[57] Gorman Direct, Ex. 3, p. 20, ll. 4–14, Schedules MPG 10 and MPG 11.

risk premium toward the high-end of his recommended range. Based on this assessment and a current "Baa" utility bond yield of 5.21 percent and projected Treasury bond yield of 4.40 percent, Gorman estimated a risk premium return for Ameren Missouri in the range of 9.54 percent to 10.14 percent.[58]

Hevert also performed a Bond Yield Plus Risk Premium analysis. He defined the equity risk premium as the difference between the authorized ROE and prevailing Treasury yields at that time over the period 1980 through April 15, 2014. This resulted in an average equity risk premium of 4.43 percent. However, Hevert asserts that the equity risk premium has a negative relationship with current interest rates. Hence, when interest rates fall, the equity risk premium goes up. To model and adjust the equity risk premium for this relationship, Hevert runs a semi-log regression analysis and applies the resulting regression formula to three different interest rate scenarios: a current, near-term projected, and long-term projected. The indicated cost of equity estimates from these three scenarios are 10.20 percent, 10.34 percent, and 10.77 percent, respectively.[59]

Gorman explains in his surrebuttal testimony that Hevert's analysis fails to consider the risk differences associated with investing debt and equity securities and that Hevert makes no attempt to measure the movement in the equity risk premium based on changes in investment risks of these securities. As Gorman points out, a *reasonable* application of the risk premium model would yield results more in line with Gorman's adjusted results of Hevert's DCF and CAPM analyses.[60]

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[58] Gorman Direct, Ex. 3, p. 24, ll. 10–11.

[59] Hevert Rebuttal, Ex. 7, pp. 52-54 and Schedule RBH-14.

[60] Gorman Surrebuttal, Ex. 4, p. 31, l. 21 – p. 32, l. 2.

5. Capital Asset Pricing Model ("CAPM")

Gorman also relied on a capital asset pricing model (CAPM) analysis to develop his recommended return on common equity for Ameren. The underlying theoretical basis for the CAPM method is that the market requires a return on a security investment that is equal to a risk-free rate of return plus a market risk premium associated with the specific security.[61]

The CAPM requires an estimate of the market risk-free rate, the Company's beta, and a market risk premium. Because the risk-free rate is typically represented by U.S. Treasury securities, Gorman used *Blue Chip Financial Forecasts*' projected 30-year Treasury bond yields for his risk-free rate. The beta term in his CAPM analysis is the average *Value Line* beta estimate for his proxy group of comparable companies. The expected market return used to calculate the market risk premium was developed by Gorman using two market risk premium estimates of the return on the market. The first was a forward-looking estimate based on published estimates of the long-term historical real return on the market (proxied by the S&P 500), plus consensus analysts' inflation projection. This produced a market risk premium of 6.6 percent. The second estimate was based on estimates of total return and risk-free return components of the long-term historical market risk premium published in Morningstar's Stocks, Bonds, Bills, and Inflation 2013 Yearbook of 5.7 percent.[62]

Gorman also reviewed the risk premium estimates developed by Morningstar in the range of 6.0 percent to 6.7 percent.[63] To be conservative, Gorman relied on the highest market risk

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[61] Gorman Direct, Ex. 3, p. 24, ll. 12-16.

[62] Gorman Direct, Ex. 3, p. 27, ll. 1–21.

[63] Gorman Direct, Ex. 3, p. 28, l. 3 – p. 29, l. 14.

premium estimate or 6.7 percent for use in his CAPM study.[64] Gorman's CAPM analyses for his proxy groups produced return on equity estimate of 9.18 percent.[65]

Hevert developed his CAPM analysis predicated on two different forward looking market risk premiums. Hevert calculated his market risk premiums by performing a DCF analysis on the S&P 500 using growth data from *Bloomberg* and *Value Line*.[66] The DCF results show a return on the market of 13.91 percent and 12.31 percent.[67] These results assume growth rates of 11.75 percent and 10.18 percent, respectively. Hevert then subtracts a current 30-year Treasury yield from his calculated returns on the market to obtain his market risk premiums of 8.71 percent and 10.31 percent. The indicated range from Hevert's CAPM analysis is 10.27 percent to 12.08 percent.[68]

Gorman correctly points out that the growth rates of the market that Hevert assumed are significantly above a sustainable long-term growth rate, which is required by the constant growth DCF model. To correct this flaw in Hevert's analysis, Gorman relies on his market risk premiums of 6.2 percent and 7.0 percent, which are corroborated by Morningstar's 2014 Classic Yearbook. Gorman's adjustments to Mr.Hevert's CAPM analysis yields a more reasonable range of 8.35 to 9.50 percent.[69]

6. Complainants' ROE Recommendation

As demonstrated by the foregoing, Gorman's testimony is reasonable and reliable. The Commission should adopt his recommended ROE of 9.4 percent for Ameren in this case. Because the recommended ROE is based on the cost of equity for companies with risks similar to

[64] Gorman Direct, Ex. 3, p. 29, l. 17.

[65] Gorman Direct, Ex. 3, p. 29, l. 18.

[66] Hevert Rebuttal, Ex. 7, p. 50, ll. 10–13.

[67] Hevert Rebuttal, Ex. 7, Schedule RBH-11, p. 7 and p. 14.

[68] Hevert Rebuttal, Ex. 7, pp. 49-51 and Schedule RBH-13.

[69] Gorman Surrebuttal, Ex. 4, p. 30, ll. 6–12.

that of Ameren, it is commensurate with returns investors could earn by investing in other enterprises of comparable risk and will allow capital to be attracted to Ameren Missouri under reasonable terms.

V. CONCLUSION

The Commission has before it all relevant factors that establish that Ameren Missouri's current rates allow it to recover $49,442,000 per year in excess of a reasonable ROE. No regulatory principle precludes granting the Complainants the relief that they seek. The Commission's statutory obligation to set just and reasonable rates that balance the interests of utilities and their subscribers favor reducing Ameren Missouri's revenues to better match rate base expenses, revenues, and returns until the Commission orders new rates in Case No. ER-2014-0258.

Respectfully submitted,

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ATTORNEYS FOR COMPLAINANTS

CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been emailed this 15th day of August, 2014, to all counsel of record.

/s/ Edward F. Downey